



AMBASSADE DU GRAND-DUCHE
DE LUXEMBOURG
2200 MASSACHUSETTS AVENUE, N. W.
WASHINGTON, D. C. 20008
(202) 265-4171

The notes attached
are for public
record.

30 August 1985

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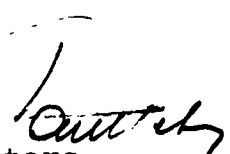
Dear Secretary Shultz,

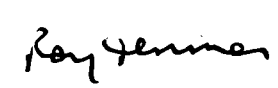
Referring to our note verbale of August 8, we have the honor to convey to you the enclosed note verbale on unitary taxation on behalf of the Governments of the Member States of the European Communities and the Commission of the European Communities.

This note is submitted in response to the Treasury Department's request for comments on the draft legislation concerning unitary taxation that it had proposed on July 8.

We avail ourselves of this opportunity to renew to you the assurances of our highest consideration.

Sincerely,


Paul Peters
Ambassador of Luxembourg


Roy Denman
Head of Delegation
Commission of the European
Communities

The Honorable
George P. Shultz
Secretary
U.S. Department of State
Washington, D.C. 20520



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Paul Peters
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Roy Denman
Head of Delegation
Commission of the European
Communities

The Honorable
James A. Baker III
U.S. Department of the Treasury
Washington, D.C. 20220



AMBASSADE DU GRAND-DUCHÉ
DE LUXEMBOURG
WASHINGTON, D. C.

1. The Governments of the Member States of the European Communities and the Commission of the European Communities wish to take advantage of the opportunity offered by the U.S. Government to comment on the proposed Federal Unitary Taxation Spreadsheet Legislation published by the Department of the Treasury on 8 July 1985.

They welcome the publication of the aforementioned proposed legislation as a contribution to a satisfactory solution of the problem of worldwide unitary taxation. They would like, however, to point out that some aspects of the proposed legislation cause concern to them.

2. The main areas of concern to the Governments of the Member States of the European Communities and the Commission arise from the definitions of "qualified state" and of "worldwide unitary basis". Under the proposed legislation, notwithstanding the fact that it applied a worldwide combination, a state would qualify in three cases :

- a) failure to comply with legal and procedural requirements;
- b) failure of the taxpayer or a foreign government to provide information after proper request;
- c) failure of separate accounting to prevent evasion of taxes.

On a) the Governments and the Commission subscribing to this note object to the application of the system of worldwide unitary taxation.- They equally object to the imposition of this method of taxation as a sanction to achieve certain legal or procedural

requirements. Worldwide unitary taxation leads to a distortion in the international attribution of income for taxation purposes. The imposition of fines would seem to them the appropriate way of dealing with non-compliance.

On b) the proposed legislation mentions failure of a foreign Government to provide information sufficient to determine the arm's length nature of transactions within a reasonable period of time as a ground for returning to worldwide unitary taxation.

Even when double taxation agreements have been revised, the Governments and the Commission are concerned that the draft legislation does not provide adequate safeguards against information provided under treaties, and passed on to the States, being used other than for the purpose of applying unitary taxation to the relevant corporation.

The Governments and the Commission assume that, pending revision of treaties which, in their present form, do not allow the passing on to qualifying states of information provided by a foreign tax administration to the Internal Revenue Service, this provision does not subject their companies to worldwide unitary taxation. Further, these Governments and the Commission assume that inability on their part to provide information sought by states does not entail the imposition of worldwide unitary taxation.

On c) the proposed legislation mentions failure to prevent evasion of taxes or clearly reflect income, even after appropriate adjustment,

as a ground for imposing worldwide unitary taxation. The Governments and the Commission joined in these representations are unclear when such a case would occur. Separate accounting, where necessary adjusted for deviations from arm's length conditions, is the internationally agreed yardstick to measure the international distribution of income for taxation purposes. They, therefore, fear this case will cause much uncertainty for their taxpayers.

With respect to the definition of the worldwide unitary basis the Governments and the Commission note that the proposals almost entirely reproduce the concept of the water's edge combined group as defined by the Working Group under the chairmanship of Secretary Regan, as he then was. As they have pointed out earlier, this definition still causes them concern on a number of points. The Governments and the Commission refer in this respect to the letter of 16 January 1985 from the Chairman of the OECD Committee on Fiscal Affairs to Secretary Regan. In particular they are concerned about the thresholds for foreign companies to be included in the water's edge combination and about the definition of tax havens; the treatment of banks and certain other financial institutions is also unsatisfactory.

They would urge the Department of the Treasury:

a) to substitute for the thresholds mentioned in the proposal the internationally accepted criterion of permanent establishment, and to tax foreign companies having a permanent establishment within the United States on a separate entity basis. This is the approach recommended to the States by former Secretary Regan in his letter to President Reagan on August 31, 1984.

b) to bring the definition of tax havens into the proposed legislation and to align it with the guidelines accepted by the OECD countries (*).

c) to insure that banks and other financial institutions are treated for tax purposes as subsidiaries, hence removing the present discrimination against such institutions arising from the fact that they generally operate on a branch or agency basis.

3. The Governments and the Commission welcome the proposed legislation as a contribution towards finding an internationally acceptable solution for the problem of worldwide unitary taxation. The proposed legislation in its present form, however, would offer federal assistance to States that have adopted or intend to adopt legislation which does not meet the concerns of these Governments and the Commission. Thus this legislation falls short of providing a stimulus to the States to adopt legislation that would actually solve this long-standing problem in a satisfactory way.

4. Our Governments and the Commission wish to express the hope that the Federal Government will continue to exert all its influence

(*) A tax haven is broadly defined as any country or territory which promotes improper shifting or sourcing of income or expenditure by virtue of its tax structure and/or tight banking or commercial secrecy provisions.

to convince the States of the necessity of finding an internationally acceptable solution to the unitary tax issue, or failing that, will propose further legislation of its own to achieve the same objective.



Washington, D.C.

August 30, 1985